

AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES

Affiliated with AFL-CIO

1325 Massachusetts Avenue, N.W., Washington, D. C. 20005



STATEMENT BY

KENNETH T. BLAYLOCK

NATIONAL PRESIDENT

**AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES
(AFL-CIO)**

BEFORE THE

**SUBCOMMITTEE ON CIVIL SERVICE, POST OFFICE AND GENERAL SERVICES
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE**

ON

S. 1527, "CIVIL SERVICE PENSION REFORM ACT OF 1985"

SEPTEMBER 9, 1985

On behalf of the 750,000 Federal and District of Columbia employees we represent, the American Federation of Government Employees, AFL-CIO, appreciates this opportunity to testify before the Senate Government Affairs Committee on S. 1527 and the design of a staff retirement plan for employees hired after December 31, 1983.

The issues surrounding the design of a new retirement plan are technical and complex. The committee members and their staffs are to be congratulated for their careful and deliberative approach and subsequent mastery of the technicalities of the issues.

Because of this process, near consensus on several major issues has been reached, including:

- o The plan should be composed of three tiers; Social Security, a defined benefit component, and a Capital Accumulation Plan.
- o The "add-on" approach is the preferred method of integration.
- o The special job requirements of law enforcement, firefighters, National Guard technicians, and air traffic controllers require special retirement treatment.
- o The existing Trust Fund arrangement should be integrated with the new plan.

Certainly much ground has been covered since the introduction of Senator Stevens' first proposal several years ago. AFGE is appreciative of the recognition of many of our concerns.

However, these points of agreement should not obscure the fundamental philosophical differences which remain.

It has always been our view that the correct and appropriate

method for addressing the design of a Supplemental Retirement System was first to clearly identify the objectives of the system. Then, once the objectives were defined, to design the best possible system to fulfill those objectives.

In our view, S. 1527 attempts to do this. The objectives of the bill are plainly stated and the design clearly follows from those purposes. Thus, our major disagreement with this plan stems from a fundamental disagreement over the objectives upon which the plan rests.

Nowhere in the bill's purposes (and likewise, nowhere in the body of the bill) is there a clear recognition of the personnel role a retirement plan plays in fostering an experienced, career work force, nor a solid commitment to it. Nowhere in the bill's purposes (nor in its body) is there a commitment to equity between current and future employees. And, nowhere in the purposes (nor in the body of the bill) is there a clear recognition of the role that retirement plans play in our society, and a commitment to economic security for the retired, the disabled and to surviving spouses and children of deceased workers. Consequently, the plan, as designed, provides inadequate benefits overall. The benefits which are provided favor the short-term, higher paid managers at the expense of the majority of the Federal workforce -- the career federal employee. In some ways this plan could be interpreted as a plan tailor-made for political appointees.

Perhaps this is understandable. There has been much written and

considerable concern expressed by knowledgeable experts on Federal management regarding the "brain drain" in Federal service and the government's inability to recruit and retain the best and the brightest into its managerial ranks. This bill would seem to try to address this problem by creating a retirement plan that is most attractive to the highest-paid executive or professional. Not only is this unfair to a majority of the workforce, but we do not think this will work. The retirement system of the United States government should not be distorted by attempting to make it a recruitment tool for a small percentage of the total workforce. The personnel problems of the Federal government are larger than one component of the total compensation package. Therefore, solutions must be sought in analyzing all of the components of the total compensation package.

Virtually all employers recognize the value of a stable, experienced and dedicated workforce. Congress clearly recognized this objective when it designed the Civil Service Retirement System by designing the plan to encourage persons to establish a career in the government service. To now design a plan which favors short-term, high paid employees is a radical departure from this basic objective. The Federal government with its constant political turmoil at the top of its management has a special and crucial need for such a work force to keep the basic systems of government effectively operating in a consistent manner. A retirement plan

which neglects this fundamental objective -- that of weighing benefits for the long-term career employee whose salary is in the lower to middle income bracket -- is deeply flawed.

From the viewpoint of the employees, the retirement plan must be fair and equitable. This concern is especially important here. For many years to come we will be dealing with two separate retirement plans for Federal employees who, in many cases, will be working side-by-side in the same job category. Our current members in the existing Civil Service Retirement System (CSRS) are worried that the new plan will drive down the benefits in their retirement plan. This concern is particularly verified when one recalls the many statements made by Congressional members advocating universal coverage that it would not impact on the Federal Retirement System. Yet here we are, two years later drafting a new plan and faced with a general recognition that the total retirement program will offer less benefits. Our new members are asking that this new plan not be inferior. Certainly there will be differences between these two plans. But the wider the differences between them, the more unfair and the more threatening those differences will appear to be. We must seek to minimize those differences and inequities. This, in our view, must be one of the objectives in the design of the new plan.

The final test of the worth of any retirement system is whether it not only protects the workers and their families from indigence and calamity but that it provides the ability to retire with security and dignity in old age and security in the case of dis-

ability and death. In this century there has developed a social mandate that in exchange for productive labor, society and employers are obligated to provide such security and dignity, as part and parcel of fair and decent wages and as a right of citizenship. In President Roosevelt's words in his June 8, 1934, Message to Congress:

" . . . Among our objectives, I place the security of the men, women, and children of the nation first . . . Fear and worry based on unknown danger contribute to social unrest and economic demoralization. If, as our Constitution tells us, our Federal Government was established among other things, 'to promote the general welfare,' it is our plain duty to provide for that security upon which welfare depends."

Thus began the American system of Social Security whose 50th anniversary we celebrate this year. Since then, virtually every major employer has bolstered that system with additional pensions and benefits, making the two inseparable and interdependent, a baseline for the value of labor and a floor of social insurance. The Civil Service Retirement System predates Social Security and it not only embraced the Social Security objectives but specifically recognized the Government's obligation to meet its social responsibility to provide its employees with security and dignity in their retirement.

If Congress is to establish a just retirement system for new Federal employees, it must reinforce these three objectives--to promote equity between employees, to give incentives for a career work force, and to insure economic security for the majority of the workforce -- those employees in the lower and middle salary ranges.

I. EQUITY BETWEEN CURRENT AND FUTURE EMPLOYEESEQUITY IN BENEFITS

We have long held that the existing employer cost of the Civil Service Retirement System (about 25% of payroll) should be the employer cost of the new system. It is important to recognize the reasonableness of this number. Even with an employer cost of 25% of payroll, the current civil service retirement system (CSRS) cannot be duplicated because Social Security provides benefits which are not provided under the existing CSRS. In addition, the new plan is a diminution of the potential retirement benefits available to Federal employees because Federal workers will never again be able to draw independently from both Social Security and Civil Service Retirement. Finally, given the fact that all parties agree that a Capital Accumulation Plan (CAP), based on voluntary employee contributions will be a component of the retirement system, employees generally will be contributing a larger portion of their pay for retirement purposes than current employees in order to maintain the same amount of employer benefits.

We and our prospective new members can live with all three of these facts, which are part of the price that we pay for this new plan. But to reduce benefits further because the employer wants to cut his share of the costs would be punitive and will jeopardize the basic principle of fairness and equity. Quite frankly, a plan which costs 20.8% payroll cannot meet the major objectives of a just retirement plan for Federal employees and their employer. We urge this Committee to invest as much in the future employee as the

government has seen fit to invest in employees of the past. It is only fair.

EQUITY IN CONTRIBUTIONS

When we testified before this Committee on the Federal Employees' Retirement Contribution Temporary Adjustment Act, we argued strenuously for the principle that pre and post-1984 should make equal mandatory retirement contributions. We still endorse this principle and therefore urge this Committee to adopt a provision for level contributions. From such contributions, the employees' Social Security obligations would be met and the balance could then be used to improve the defined benefit portion of the plan.

EQUITY FOR SPECIAL RETIREMENT CATEGORIES

S. 1527 severely and unwisely restricts the definition for law enforcement and firefighter personnel by limiting coverage, applying a new standard of "rigorous" work, and eliminating some positions in these occupations. In discussions with Committee staff, they explained that the current CSRS covers positions which they think do not deserve coverage and they cited as an example kitchen employees in the Bureau of Prisons (BOP). Yet BOP kitchen employees spend every day working side-by-side with hardened criminals who have access to kitchen utensils--knives and meat cleavers. Inmate attacks upon all prison personnel, not only correctional officers, have dramatically increased over the last decade. The positions are filled with danger and stress. Turnover within virtually all personnel in the BOP is at alarmingly high rates. Eliminating

coverage for the full range of BOP personnel would be a very serious mistake for the government and would unfairly compensate many employees who are exposed to constant danger.

Eliminating coverage for certain managerial and office positions when "line" law enforcement officers and firefighters are promoted into those positions also makes little sense. Basically, you penalize an employee for a promotion. The government would likely lose many valuable and capable people for such positions.

Obviously, no definition for these special occupations will be perfect. If there are undeserving positions, we will work with the Committee to address these problems. However, the proposed language is a case of throwing out the baby with the bath water.

The current retirement system for these special occupations permit retirement at age 50 with 20 years' service, with mandatory retirement at age 55. It provides for increased contributions (7.5%), a higher accrual rate, and full indexation. S. 1527 calls for a normal retirement at age 55, with 25 years' service, no mandatory retirement, no contributions, an undifferentiated accrual rate, a Social Security supplement indexed by wage movement, a CPI-2 COLA, and optional participation in the thrift.

The differences are far too wide. Under the current system an employee with a final salary of \$30,000 at age 50, with 20 years' service, retires with a fully indexed annuity of about \$14,200. Under the new system the same employee's annuity would be only \$3,450. Even at age 55, when the Social Security supplement became

effective, the new employee's annuity would be only \$7,450 compared to \$17,298 under the existing system.

We believe that special retirement provisions for these occupations have been driven by the unique demands and requirements of these jobs. These demands and requirements have not changed and need to be accommodated in this new retirement plan. Although this plan does provide some recognition of the special nature of these occupations, we think the proposed provisions are inadequate. We urge the committee to maintain an unreduced pension (with a Social Security supplement) at age 50, with 20 years' service. We further urge that the accrual rate be bolstered for these categories to provide for an adequate replacement rate. (This could be coupled with a higher contribution rate for these employees.) Finally, we think that, for the sake of consistency, the Social Security supplement should be indexed by the Consumer Price Index rather than the Average Indexed Monthly Earnings, as proposed.

II. INCENTIVES FOR A CAREER WORK FORCE

There are many ways to define retirement benefits so as to encourage and reward long-term, career employment.

THE SIZE OF THE CAP AND THE NEED FOR INCENTIVES FOR A CAREER WORK FORCE

In reference to S.1527, perhaps foremost among these would be the weight of the CAP as it relates to the defined benefit.

The CAP, as it is proposed, favors high income and short-term employees. The risk of the poor economic performance of investments becomes a burden on the employee, one that the average employee is less able to bear.

Although we have agreed to include a CAP in the plan, we think this plan makes employees far too dependent upon it for their economic security, and because the lower and average wage-earners are least likely to use it, it will mostly benefit the highly paid. In addition, unlike the private sector norm, this plan allows vesting for employer-paid matching contributions after only one year. Clearly this is intended to benefit the short-term employee, especially the high-paid political appointee.

We do not object to this per se--if that is a benefit Congress wants to provide--but we do object to providing such a benefit at the expense of reducing the defined benefit portion of the plan which is most heavily relied on for retirement purposes by rank and file employees who, unlike the political appointee, are committed to a lifelong career in government. Since a CAP shifts the burden for a decent retirement from the employer to the employee, the defined benefit plan must be large enough to ensure economic security.

If the CAP is as large as in the proposed legislation, it threatens the adequacy of the defined benefit plan. We urge the committee to redefine the CAP, to reduce the relative weight of it--perhaps to a formula more like a 50% match up to 6% of pay. The cost savings of changing the formula should be used to bolster the defined benefit portion of the plan.

VESTING IN THE CAP AND A CAREER WORK FORCE

Another proposal to offset how the CAP favors short-term workers

would be to increase the vesting period for the government's match.

The current proposal would provide partial vesting of the government's match after just one year, increasing by 20% per year until fully vested in the government's match by the end of five years. We would suggest that the government matching contribution not begin to be vested until five years, and not fully until the end of ten years of Government service.

There are many alternative vesting schedules which are feasible such as eliminating the vesting schedule and vesting the entire government's contribution at five years. The resulting cost savings should be used to bolster the defined benefit portion of the plan.

THE ACCRUAL RATE AND A CAREER WORK FORCE

The existing CSRS rewards and encourages employees to make a career of Federal service by a seniority weighted accrual rate which pays higher benefits for many years of service. The existing accrual rate is 1.5% for the first five years, 1.75% for the following five years, and 2% thereafter.

S. 1527 proposes a flat 1% accrual rate. There is no reward for long-term service.

As part of the objective to promote a career work force, we urge the Committee to adopt a seniority weighted accrual rate, such as the following:

- 1) .5% for the first 10 years of service
- 2) 1% for the next 10 years of service
- 3) 1.75% thereafter

With 30 years of service this would provide a replacement rate of 32.5% compared to 30% under the proposed accrual rate. This proposal would not necessarily add to the cost of the plan. In fact we believe this specific proposal does not add to the cost. And while we do not believe that a 32.5% replacement rate is adequate, this would be a move in the right direction. Indeed, as we have said elsewhere, we believe the defined benefit is not adequate and must be improved. Fundamentally that means some increase in the benefit formula. But for the sake of illustrating the issue of how a "stepped" accrual rate provides an incentive for career employees, we have suggested this "no-cost" option to the proposed bill.

III. ECONOMIC SECURITY IN RETIREMENT PLANS

COLA'S

With the onset of persistent inflation during the 60's, it became increasingly obvious that retirement programs which are solely defined without regard to inflation would fail in their goals of providing for retirement with security and dignity. Inflation cruelly punishes those on fixed incomes who have no ability to engage in paid employment. As a result, in the 60's and 70's many retirement plans, including Social Security and CSRS, began making provisions for cost-of-living adjustments.

It is also important to note that unlike any other employer, the Federal government through its fiscal and monetary policies is directly responsible for inflation. Thus, the Federal government has a unique responsibility to protect its elderly retirees from the

consequences of its own action. And, it is only fair that COLA provisions between government programs designed to ensure economic security are all treated equally. For this reason, we urge the committee to reject the proposed CPI minus two and provide for a COLA for the CSRS which is the same provided to Social Security recipients.

THE RETIREMENT AGE

One of the major advances for working people in the history of this country was achieved by enactment of the Social Security program and the spread of employer pension plans. This allowed workers to retire as a reward of lifelong labor and to enjoy his or her remaining life with economic security. To penalize the long-term career employees for wanting to enjoy that reward while their health is good and they have many years to live is wrong. A penalty for early retirement is not fair in such cases. We could understand a penalty for early retirement if this benefit were very large and costly, but it is not. Under most circumstances, retirees will wait until 62 to retire so that they will receive all retirement benefits - Social Security and CSRS because otherwise they would not have sufficient retirement income.

THE SOCIAL ROLE OF RETIREMENT AND THE PLAN'S COVERAGE

A premise upon which all parties in this debate can concur is that all employees who work for the Federal government are entitled to a retirement plan. Therefore, the proposal should specifically include intermittent or seasonal employees, temporary employees, as

well as non-appropriated fund employees.

Perhaps, in the past, the exclusion of these groups could be overlooked insofar as they could be seen as unlikely to vest and unlikely to benefit from inclusion. This is no longer the case because:

- 1) OPM has recently pushed agencies to substitute temporary and intermittent employees for permanent employees.
- 2) OPM has granted agencies new authority to make and extend temporary appointments up to 4 years and longer with OPM approval.
- 3) Because of tightening agency budgets, agencies are abusing these powers by substituting non-covered employees for permanent employees for the sole purpose of avoiding benefit costs. The Exchange Services in DOD have been prime violators of this practice.
- 4) Certain agencies such as the Forest Service and Social Security have undertaken employment practices where individuals work for recurring periods over many years of time in the same position. These employees are basically permanent, intermittent employees and should be able to participate in the retirement plan.

For the above reasons, the GAO has already recommended making all Federal employees eligible for the full range of Federal compensation, including Civil Service Retirement (see GAO, Part-Time and Other Federal Employment: Compensation and Personnel Management Reforms Needed, (FPCD-78-19, June 5, 1979), and we urge the committee to include this recommendation in this bill.

SURVIVOR BENEFITS AND SOCIAL POLICY

The family as a social institution is the bedrock upon which our civilization rests. Although the family structure has undergone profound changes over the years and every so often pop-theorists

predict its demise, marriage and families with children continue to demonstrate the American way of life. The family is reflected in Social Security spousal benefits; tax treatment of the two-wage earner family; poverty definitions; and virtually every public policy. As a matter of fact, public policies often turn on whether the issue is seen as pro-family for anti-family.

The survivor provisions in this bill are anti-family. By requiring an actuarial reduction, to provide a survivor benefit, most employees could not afford to retire and provide for a survivor annuity. Therefore, the economic security of the surviving spouse and children in the families is threatened. These provisions are among the most disappointing in the bill.

Take the example of the \$30,000 per year employee who dies at age 50 with 30 years of service and a 45 year old spouse. First, the spouse would not be eligible for any annuity for 5 years. Obviously finding an adequate income at age 45 for a widow or widower, possibly with school-age children to support, is not a good prospect. The employee's annuity, if he was age 62, would have been \$8,100. Applying the 2% penalty per year for age 55 retirement, leaves \$6,960. Applying the actuarial reduction for providing the survivor annuity leaves about \$6,100--the reduction would be larger if the spouse was younger. The surviving spouse would then receive half that, or \$3,050, when she reached age 50, five years later. No Social Security benefits may be forthcoming until age 60, and since this survivor's benefit is not fully indexed, the survivor would be

effectively diminished by inflation to about \$2,600 (in constant dollars) by age 60.

While the plan would also provide a group term life insurance at no cost to the employee--and we do endorse that provision--the final benefit amount clearly is not enough to replace the loss of income felt by death of the wage-earner.

We urge the committee to:

- 1) Substitute a reasonable flat reduction to "purchase" the survivor's annuity instead of an actuarial reduction.
- 2) Provide the survivor annuity immediately and without restriction upon the death of the employee.
- 3) Calculate the survivor benefit on the employee's unreduced annuity.

Finally, we urge the Committee to continue benefits for children under the new survivor provisions, similar to the current CSRS. Since Social Security does provide sufficient benefits for children before age 18, we do not seek any supplement except for those between age 18 and 22 who are in full-time attendance at school. We note especially that this benefit is so small in cost that for all the security it provides to families, it is more than a thousand fold worth the investment.

IV. OTHER MAJOR ISSUES

There are two major non-design issues with which we strongly disagree. The first involves the funding mechanism. The second concerns the administration of disability program.

The bill would provide dynamic normal cost financing which would eliminate future scare mongering around the unfunded liability

issue. We have no basic problems with this approach.

However, we do take strong exception to providing this financing out of agency appropriations. Forcing agencies to take this money out of salary and expense accounts would make budgetary planning much more difficult because it would crucially depend upon the ratio of current to new employees, the rate of turnover, and the transfers into the new system. Furthermore, appropriation committee members and staff would need to understand that although greater appropriations are required for a given number of employees, these greater appropriations in no way affect the deficit, but only relates to a bookkeeping innovation to account for retirement obligations as they are earned rather than financing them by direct transfer mechanisms from the general Treasury to pay benefits as they are due.

These concepts can befuddle even the intelligent, who are well intentioned. In the hands of those with less insight and understanding or less honorable intentions, they can create intellectual chaos. In all likelihood, these analytical niceties would fall by the wayside in these years of budget crisis. Freezes on agency appropriations, where dynamic normal retirement costs were not explicitly recognized in the past, would translate unthinkingly into large personnel cuts once these costs were explicitly accounted for.

Interestingly the idea of using appropriations to fund the

retirement plan is not new. Historically the Trust Fund was dependent upon annual appropriations until 1969. Its financing ran into trouble because of it. For this reason, employees do not have faith in a system dependent upon annual agency appropriations.

We urge the committee to avoid these problems by using a direct transfer mechanism between the Treasury and the Civil Service Retirement Fund.

The other non-design issue which is of concern to us is the proposal to contract for disability insurance with private insurance companies who would administer the program and pay out the benefits. The government already has (within OPM) the ability to administer the program. It makes no sense to try and duplicate (and pay additionally for) such functions by private sector contracts.

It would create a situation where employees would inevitably be treated differently by different insurance companies. Accordingly, we recommend that the Disability Trust Fund and program continue to be managed by OPM.

There are numerous other issues about which we also are concerned, and we have itemized here for reference and are prepared to explain them in greater detail as needed:

- 1) The disability provisions, in general, are well conceived and ably designed. However, the period of the long-term disability (LTD) should be increased from 1 year to 2 years in order to provide a more realistic opportunity for rehabilitation. This would not preclude medical reevaluations during such period of course, on account of which the benefit period may be terminated.

Additionally, we would propose that disability benefits continue until the annuitant is eligible for an unreduced retirement benefit under Social Security or the Civil Service, as appropriate. We note that Social Security disability benefits continue until the wage-earner is eligible for a full retirement and we think this practice should be paralleled.

- 2) Because of potential ambiguity in the proposed definition of military service technician, we suggest that National Guard technicians be specifically referenced. Also, because these civilian technicians have a mandatory retirement age of 60, they should be provided with a supplement equal to their Social Security benefit at age 62 until they are eligible for Social Security. This would be similar to the provision for fire fighters, law enforcement, and air traffic controllers. Finally, those technicians who lose their civilian job as a result of losing their military status for non-disability reasons should be eligible for an unreduced annuity at the time of separation.
- 3) There is currently a provision to allow individuals on leave-without-pay for union activities to continue in the retirement plan. Such individuals pay the equivalent of agency and employee contributions (14% of pay). S. 1527 should be amended to include a similar provision.

- 4) The interest on the investments of the CAP in government securities is tied to 2-year securities. This, unrealistically, lowers the employees' interest from this source and would encourage them to withdraw their funds from government securities. We urge the interest be determined from longer-term securities, as is the current practice, or from a favorable index of the range of government securities.
- 5) Section 8461 permitting unrestricted contracting-out of the administration of the retirement program should be deleted.
- 6) We think the one-year period for the transfer option is too restrictive. It simply is not enough time for employees to weigh their options and trade-offs. Regulations implementing this provision may not be complete until well into that one-year period. We urge the one-year period be extended to two years.
- 7) District of Columbia employees will not be covered by this plan and new D.C. employees will be severed from the Civil Service Retirement System effective January 1, 1987. In order to provide for an orderly transition and to allow D.C. employees (and their representatives) and the D.C. Government time to adequately prepare and negotiate over this major change, we urge that this date be moved to January 1, 1989.
- 8) A major step forward in the debate over Civil Service retirement has been accomplished in the effort to design

this system; namely, everyone is singing from the same song book--the model developed by the Congressional Research Service with assistance from the General Accounting Office, Congressional Budget Office, and outside experts. For this reason, we urge consideration of using this model in calculating the dynamic normal cost of the system. Furthermore, we strongly urge that the legislation require this cost be the operative cost for all government decisions which include retirement as a factor (such as A-76 contracting-out studies).

- 9) One way to increase portability would be to allow service transfer between retirement systems in the Federal government such as between railroad retirement and Civil Service retirement.
- 10) Care must be taken in this new plan not to unthinkingly disrupt the unique requirements and personnel system in the Foreign Service. We would hope that this committee would carefully deliberate before any such precedents were introduced.
- 11) The definition of basic pay should be clarified to insure that it means pay established pursuant to law and subject to any applicable pay ceilings.

Finally, we would like to touch on one of the most complex areas in this whole issue -- the management and investment of the funds in the CAP. Because of this complexity, we are still investigating the range of options and still evaluating the proposal in the bill.

Our investigations will be based on several principles.

First, these monies are the employees' money and must be invested in their best interest. Second, because of the size of this fund, the public interest must be represented and guarded. Third, once again, because of the fund's size, the danger of disrupting markets, inadvertently or for political purposes, must be guarded against. Fourth, the use of this fund must be socially responsible and such responsibility should be a feature of its investment strategy. Finally, ERISA standards should serve as guidelines to the administration of the fund in order to protect the integrity of the investments.

We will continue our research and discussions along these lines, and look forward to working with the Committee soon on these challenging and proactive issues. We wish to add in closing that we agree with the Committee that a good part of these funds should be invested in the private sector. Employees deserve the greatest available return for their dollar. We do not believe the currently proposed investment strategies would do that, and that is one of the reasons we are looking deeper into the issues.

Thank you.